

Service Date February 13, 1970

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MONTANA

* * * * *

IN THE MATTER OF the application)	UTILITY DIVISION
of the Butte Water Company for)	
authority to increase its rates)	DOCKET NO. 5749
and charges for water service.)	ORDER NO. 3361
)	
)	

* * * * *

The above entitled matter came on regularly to be heard in the Fox Theatre, in the City of Butte, Montana, commencing at the hour of 1:00 o'clock P.M. (MDT), on the 8th day of October, 1968, before the Public Service Commission of the State of Montana.

APPEARANCES

Krest Cyr, Attorney at Law, 609 Hennessy Building, Butte, Montana, appearing on behalf of the Butte Water Company.

James A. Robischon, Attorney at Law, 609 Hennessy Building, Butte, Montana, appearing on behalf of the Butte Water Company.

PROTESTANTS:

William N. Geagan, Attorney at Law, City Attorney for the City of Butte, Montana, City Hall, Butte, Montana, appearing for the Mayor and City Council of the City of Butte, Montana.

M. F. Hennessy, Attorney at Law, Assistant City Attorney for the City of Butte, Montana, City Hall, Butte, Montana, appearing for the Mayor and City Council of the City of Butte, Montana.

Mark P. Sullivan, Attorney at Law, Silver Bow County Attorney, County Courthouse Building, Butte, Montana, appearing for the Silver Bow County Commissioners in behalf

of the Silver Bow County taxpayers and the volunteer fire districts in Silver Bow County.

Neil J. Lynch, Attorney at Law, of the law firm of Genzberger, Genzberger and Lynch, 211 Miners Bank Building, Butte, Montana, appearing on behalf of 2,500 Senior citizens of Butte, Montana.

FOR THE COMMISSION:

William E. O'Leary, Counsel
William M. Johnson, Auditor

BEFORE:

PAUL T. SMITH, Chairman
LOUIS G. BOEDECKER, Commissioner
ERNEST C. STEEL, Commissioner

BY THE COMMISSION:

HELD: Application granted 8S hereinafter enumerated.
Applicant submitted testimony and exhibits supporting plane figures, operating results, and earnings, annually from 1960 through 1969, at the public hearing. These figures contained contemplated additions to the system including the Big Hole #3 Construction Project.

In applicant's brief filed July 15, 1969, the applicant requested that the Commission's test period be rolled back to that period ended December 31, 1967. In this, the Commission agrees. However, it is not possible to use the plant figures submitted for RCN and RCND valuations as of December 31, 1967. A review of the exhibits for RCN and RCND valuations submitted by the applicant, reveal projected amounts other than the Big Hole #3 in the totals submitted as RCN and RCND for January 1, 1968. This will be discussed more fully in the body of the order.

RATE BASE

The Company submitted Reproduction Cost New Depreciated

(RCND) valuations of \$10,113,597 for 1967 and \$13,530,309 for 1968. This amounts to a difference of \$3,416,712. The construction cost of the Big Hole #3 project was estimated to be \$3,400,000. Exhibit E also shows other improvements contemplated in 1968 and 1969 included in the total for 1968. These and the Big Hole J3 project have been eliminated in the Commission's considerations. The Company also included reproduction cost for intangibles and overheads. The value placed on intangibles is less than the original cost and with this the Commission has no argument. However, the matter of overheads, which included an item entitled "Commissions and contingencies", is something else. The Company here is placing a flat percentage against present value or RCND and adding this to the RCND valuations. This purportedly represents such things as organization expense, legal expense, engineering and supervision, interest during construction, taxes and insurance, and omissions and contingencies. What the Company is saying here is we may have forgotten something, so we will put it in now. The Commission may as well allow the protestants to take 15% off the rate base for something which they may have forgotten to bring out at the hearing. It was disclosed at the hearing that these items had probably been expensed or charged to plant at the time of the construction. If they had been expensed, the rate payer has paid for them once and this Commission has not and will not allow them to be placed in the rate base at this time. This would be charging the users of the system twice. If they had been placed in plant at the time of the construction, there is no necessity to do so at this time. The Commission has eliminated from consideration the sums of \$4,188,404 from the Reproduction Cost New (RCN) valuations and the sum of \$2,352,342 from the RCND valuations and has inserted a valuation for the intangible costs in both. This being an old company, some of its plant has reached

the stage of economic obsolescence as far as RCND valuations are concerned. Simply put the cost of maintaining, plus the carrying charges, exceeds the cost of maintaining and the carrying charges of new equipment on an RCND basis. Let us look at the Big Hole #1 and #2 pipelines comprised partially of wood pipe as an example. The Company witnesses went to great lengths describing the maintenance efforts involved in keeping the lines functioning. [The Company introduced into evidence samples of the wood line and bands to show the extent of the depreciation of the pipeline and the terrible condition of the remaining portions of the line. By replacing this line with a low maintenance line of other material, the overall cost to the consumer would be lessened. We are not saying that the line could not have Original Cost Depreciated (OCD) value, but only that economic obsolescence has removed most RCND value. The Commission has examined all items of plant shown by the Company and eliminated those determined to be in the economic obsolescence stage.

The Company's plant exhibit shared an RCN valuation of \$27,732,433 and an RCND valuation of \$13,530,309. This results in a percent condition of 49% or a depreciation reserve condition of 51%. The annual report to the Commission for 1967 by the Company shows an original cost (OC) valuation of \$8,237,715 and an OCD valuation of \$2,768,883. This gives a percent condition of 33% or a 67% depreciation reserve condition. However, the depreciable OC valuation would be approximately \$6,600,000 giving a depreciation reserve condition of depreciable plant of 81% and percent condition of depreciable plant of 19%. This, in effect, shows that the Company has charged to depreciation and to the rate payers 81% of the value of the depreciable plant. The Company in turn has used observed depreciation for the RCND valuations and find out that only 51% has depreciated or a difference

of 30%, or a percent difference of 59% It is interesting to note, that under cross examination the Company witness could produce no records substantiating the observed depreciation compilations. The witness stated that he arrived at the figures from viewing the plant, when possible, but had made no attempt to record his findings. The only physical evidence offered were some staves and bands, which, if indicative of the system as a whole, would refute the overall findings of the Company. This type of observed depreciation is not satisfactory to the Commission.

There was considerable discussion as to donated property at the hearing, especially concerning the lines in the pit area. The Company furnished a list of the lines abandoned and it has been determined that these lines have been eliminated from the rate base. However, the Company has been placing in its plant accounts, the full value of lines paid for by the Anaconda Company as replacement lines. The Commission has ordered that the difference in value between the line replaced and the replacement line should be bested as donated property, The property values have been adjusted accordingly

The Commission has determined the full amount of donated property received by the Company and this has been eliminated from rate base consideration. The Company has further been ordered to place donated property in the proper account henceforth.

The difference of 59% in the OCD percent condition and the RCND percent condition is one of the largest ever encountered by this Commission. While this Commission is bound by court decisions to the consideration of observed depreciation, it is not bound to accept determination such as these, based on the methods used. The Commission is also free to use other

methods to determine the accuracy of the observed depreciation.

The assessed valuation of the Butte Water Company for 1967 was determined to be \$2,712,979.

All of the above has been taken into consideration in determining that the fair value of the Company's properties devoted to public service as of December 31, 1967 is \$3,596,964.

OPERATING RESULTS

The Commission has determined that the actual results of the Company for the year 1967 produced earnings of \$159,397. These results are actual and the Commission has verified the results and the revenue and operating expense figures which were used to develop the results. The operating expenses were in line with previous years as were the revenues. The Commission therefore establishes the net operating revenues, or earnings, for the test year 1967 to be \$159,397,

RATE OF RETURN

The Company requested a rate of return of 8.5%, based on a return necessary for common stock, on the fair value of its properties.

This Company is a 100% equity Company, of its own choosing. The Commission can approach this matter in two ways.

Under one approach, the Commission would determine that no Company is entitled to a rate of return on all the fair value of its properties equal to A rate of return necessary for equity financing, and arbitrarily set a fair rate of return.

This is the belief of the Commission and it so finds. However, another non-arbitrary method will be used.

The other approach is to adopt a hypothetical equity-debt ratio. During the years this Company has been in existence, it has not approached its financing through a debt issue. It rather relied on equity financing, and it has relied in recent years on internally generated funds, almost exclusively. This of course increases, considerably, the risk to the common stockholders. It impedes rather drastically, the attempts by the Company to secure earnings to properly compensate its investors. Without debt at all, as in this case, there is, of course, no leverage which could and does affect the quality of the equity investment. There is also the factor of the income tax exemption of interest payments, which factor is of great benefit in improving the amount of earnings available to the common stockholder.

The Commission has reviewed the capitalization ratios of numerous utilities, including those utilities used by the financial witness for the company. The Commission finds that a 50/50 equity-debt ratio is a fair and reasonable hypothetical ratio to be used in this Docket. The Commission is, of course, not presuming to assume the prerogatives of management, but rather is attempting to provide a ratio which would be beneficial to the common stockholder and rate payer alike. In assuming a 50 percent debt ratio, the Commission is not limiting it to bond issues alone, but assumes that management could have issued, equally well, a portion of the 50 percent debt in preferred stock.

At the time of reviewing the capitalization ratios of other companies, the Commission also reviewed the embedded cost of debt issued over the past forty years, and found it to be approximately 4.5%.

If this Company had issued debt over the years for its construction programs and had attempted to replace some of its equity financing with debt, the Commission believes its embedded cost would be no different than the utilities listed above.

The Commission approves the request of the Company for an 8.5% return on its equity. Thus using a 50/50 equity-debt ratio with an 8.5% return for equity and a 4.5% embedded cost of debt, the Commission finds a fair rate of return, to be applied to the fair value of the Company's properties devoted to public service, to be 6.5%

CONCLUSION

The Company requested an 8.5% return on the fair value of the Company's properties estimated by the Company to be \$9,085,162 as of December 31, 1969. On this basis and with operating results projected through 1969, including additional income taxes, the Company had requested an increase in revenue of \$1,777,212.

Using the fair value of the Company's properties, determined by the Commission to be \$3,596,964, as of December 31, 1967, in conjunction with the fair rate of return determined to be 6.57., the Commission finds the required earnings of the Company to be \$233,802. The Company's earnings as of December 31, 1967, were found to be \$159,397. Thus, it is readily apparent that an increase in earnings of \$74,405 is necessary, Out of every hundred dollars of additional revenue approved, \$51.25 must be paid in federal income and state corporation taxes. It is then found necessary to increase revenues by \$152,625 to obtain the additional \$74,405 in

additional required earnings. As the surtax of 5% expires July 1, 1970, there has been no allowance for the surtax in these computations.

It is the opinion of the Commission that a 14% increase in rates for all consumers, including the industrials, will provide the necessary additional revenues.

In reviewing the present rate scheduled the Commission finds there is being levied a charge of \$3.00 for fire hydrants. In view of the small investment required, the fact that water supplied is used only occasionally, and the small amount of maintenance required, the Commission is of the opinion that a rate of \$3.00 per hydrant is sufficient. It is therefore ordered that the 14% increase not be applied to fire hydrants.

The rate for 1 to 2 room residences and flats is \$2.15, presently, with one bath and one toilet it is \$3.05, and with a laundry \$3.30. As these types of occupancies are minimum users of water, the 14% increase shall not apply and the filed rate schedules shall reflect this decision.

There is presently filed a rate schedule for cemeteries. The 14% rate increase shall not apply to this schedule due to the unusual circumstances surrounding the use of water under this schedule.

The Commission also is requiring that all schools henceforth be served under a rate schedule similar to the above.

Therefore from the evidence and for the reasons stated above, the Commission makes the following:

FINDINGS OF FACT

1. That the Butte Water Company is a public utility operating in the State of Montana and engaged in furnishing water service to the residents of Butte, Montana and vicinity and is subject to the authority and Jurisdiction of this

Commission.

2. That the fair value of the Company's properties devoted to public service as of December 31, 1967, was \$3,596,964.

3. That the earnings of the Company for the year ended December 31, 1967 were \$159,397.

4. That a fair rate of return for the Butte Water Company is 6.5%, for the purposes of this order.

5. That a fair rate of return of 6.5% taken in conjunction with the fair value of the Company's properties devoted to public service as of December 31, 1967, results in required earnings of \$233,802.

6. That additional earnings of \$74,405 are necessary.

7. That a conversion factor of 48.75 may be used in determining the additional revenues necessary to produce the required additional earnings.

8. That rate schedules based on a 14% increase in rates, except as provided above, will result in rates, that are fair, equitable, just and non-discriminatory.

CONCLUSION

The Commission concludes that the rate relief requested by the Butte Water Company in its petition be granted in part.

O R D E R

NOW THEREFORE, at a session of the Public Service Commission

of the State of Montana, held in its offices in the Capitol Building, Helena, Montana on February 13, 1970, there being present Chairman Paul T. Smith, Commissioner Louis C. Boedecker and Commissioner Ernest C. Steel, there regularly came before the Commission for final action, the matters and things relating to the application of the Butte Water Company for authority to adopt new rates and charges for water service, Docket No. 5749, and the Commission being fully advised in the premises;

IT IS ORDERED by the Commission that the Butte Water Company be authorized to file revised schedules of rates and charges for water service, incorporating therein an increase in the present schedules of rates and charges of fourteen percent and incorporating therein the special provisions set forth in the body of this order under Rates.

IT IS FURTHER ORDERED that upon the filing of a schedule of rates and charges by the Company in conformity with the above, and approval thereof by the Commission, the said schedule of rates shall be effective on all bills rendered on and after March 1, 1970.

IT IS FURTHER ORDERED that a full, true and correct copy of this Order be sent forthwith by first-class United States mail to the applicant and all appearances herein.

The foregoing Order was unanimously adopted by the Board of Railroad Commissioners ex-officio Public Service Commission of the State of Montana.

DONE in open session at Helena, Montana, this 13th day of February, 1970.

PAUL T. SMITH, CHAIRMAN

LOUIS G. BOEDECKER, COMMISSIONER

ERNEST C. STEEL, COMMISSIONER

ATTEST:

Donna Ruetten

Acting Secretary
(Official Seal)